Financial Report

Changes in Assets

HIGHLIGHTS

1
Depositors' net assets reached $200.1 billion, up $68.5 billion since December 31, 2009.

2
Over four years, net investment results totalled $61.2 billion, 54% of which came from the Equity asset class.

3
Depositors' total net deposits over four years amounted to $7.3 billion.

DEPOSITORS' NET ASSETS

Net assets grew from $131.6 billion as at December 31, 2009, to $200.1 billion as at December 31, 2013, increasing $68.5 billion over four years. This growth came essentially from net investment results of $61.2 billion and depositors' net contributions of $7.3 billion.

During 2013, depositors' net assets were up $24.0 billion to $200.1 billion, versus $176.2 billion as at December 31, 2012. The $24.0 billion increase was due to $22.8 billion of net investment results, which came mainly from the Equity asset class, and $1.2 billion of depositors' deposits (see Table 52, p. 115).

Net assets include a consolidation adjustment of $702 million ($637 million in 2012) stemming from the early adoption of International Financial Reporting Standards (IFRS) as at December 31, 2012, for the Real Estate portfolio, which includes the subsidiary Ivanhoé Cambridge. This subsidiary is valued and presented as an investment, and its valuation reflects the fair value of the business, including the fair value of its real estate assets, the quality of the portfolio and integrated management of the platform.

TOTAL ASSETS

Total assets reached $245.7 billion as at December 31, 2013, versus $213.8 billion at the end of 2012. The $31.9 billion increase is due to reinvestment of investment income, unrealized increases in value and depositors' deposits. La Caisse, which has a strong financial position, continued to manage its liabilities carefully while holding them steady at 19% of total assets. The liabilities consist primarily of short selling of securities, securities sold under repurchase agreements, derivative financial instruments and the financing programs of the subsidiary CDP Financial, which are used mainly to finance real estate investments.

ASSETS UNDER MANAGEMENT AND ASSETS UNDER ADMINISTRATION

As at December 31, 2013, La Caisse's assets under management and administration totalled $48.8 billion, up $3.5 billion from one year earlier.

This growth came mainly from the portfolio administered by MCAP Commercial LP, a subsidiary of Otéra Capital. This company administers more than $39 billion of Canadian residential and commercial mortgages, and construction loans.

NET INVESTMENT RESULTS

Over four years, net investment results amounted to $61.2 billion, with the Equity asset class contributing the most to the overall return; it generated $32.8 billion of net investment results, including almost $10 billion from the Private Equity portfolio.

In 2013, La Caisse recorded net investment results of $22.8 billion, versus $14.9 billion the previous year (see Table 53, p. 115). This increase is directly attributable to high returns on the stock markets and private equity, which produced $18.2 billion of total results for the Equity asset class. The favourable results for 2013 were also due to the Inflation-Sensitive Investments asset class, whose largest contribution came from the Real Estate portfolio, with $2.9 billion.

DEPOSITORS' NET DEPOSITS

Depositors' total net deposits as at December 31, 2013, were $1.2 billion, mainly because of the contributions made by the Retirement Plans Sinking Fund, the Régie des rentes du Québec and two new depositors.

TABLE 52

ANALYSIS OF CHANGES IN DEPOSITORS' NET ASSETS

(for the period 2010-2013 – in billions of dollars)

	2013	2012	2011	2010	4 years
Depositors' net assets, beginning of year	176.2	159.0	151.7	131.6	131.6
Investment income	6.3	5.6	5.2	4.8	21.9
Gains (losses) on the sale of investments	4.4	2.4	(0.5)	1.6	7.9
Unrealized increase in value of investments	12.4	7.2	1.3	11.6	32.5
Operating expenses	(0.3)	(0.3)	(0.3)	(0.3)	(1.2)
Net investment results[1]	22.8	14.9	5.7	17.7	61.2
Depositors' net deposits	1.2	2.3	1.5	2.4	7.3
Depositors' net assets, end of year	200.1	176.2	159.0	151.7	200.1

1. Net investment results include income generated by depositors' demand deposits and term deposits.

TABLE 53

RESULTS AND CHANGES IN DEPOSITORS' NET ASSETS AND TOTAL ASSETS UNDER MANAGEMENT

(for years ended December 31 – in millions of dollars)

	2013	2012
Investment income	6,330	5,590
Less:		
Operating expenses	287	284
Net investment income	6,043	5,306
Gains on the sale of investments	4,413	2,454
Total realized income	10,456	7,760
Unrealized increase in value of investments and liabilities related to investments	12,312	7,177
Net investment results	22,768	14,937
Depositors' net deposits	1,171	2,308
Increase in depositors' net assets	23,939	17,245
Depositors' net assets, beginning of year	176,210	158,965
Depositors' net assets, end of year	200,149	176,210
Liabilities (primarily assets financed by borrowing) and non-controlling interests	45,554	37,590
Depositors' total assets	245,703	213,800
Assets under management	7,738	7,423
Assets under administration	41,102	37,913
Assets under management and assets under administration	48,840	45,336
Total assets under management	294,543	259,136

Analysis of Operating Expenses and External Management Fees

Operating expenses represent La Caisse's total portfolio management and administration costs. External management fees are amounts paid to external financial institutions to manage funds on La Caisse's behalf. Operating expenses include expenditures for the management of the Real Estate and Real Estate Debt portfolios. Operating expenses related to the management and administration of real estate assets and mortgages are deducted from real estate investment income and mortgage income, respectively.

For fiscal year 2013, operating expenses totalled $287 million, compared to $284 million in 2012. External management fees totalled $11 million, an amount equivalent to that of 2012. In the combined financial statements, external management fees are netted from investment income.

Operating expenses and external management fees amounted to $298 million in 2013, compared to $295 million in 2012. This amount represents 17.0 cents per $100 of average net assets, placing La Caisse among the leaders in its management category (see Figure 54).

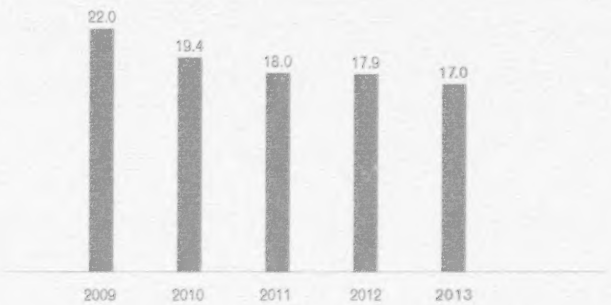
Over four years, operating expenses and external management fees went from 22.0 cents to 17.0 cents per $100 of average net assets, a decrease of five basis points.

OPERATIONAL EFFICIENCY

La Caisse periodically reviews its procedures to maintain strict control over its operating expenses. It aims to keep operating expenses at a level that, given the composition of its investments, is favourably comparable to that of same-size institutional fund managers with similar operations. For many years, La Caisse has been benchmarking its costs by asset class.

FIGURE 54

OPERATING EXPENSES AND EXTERNAL MANAGEMENT FEES EXPRESSED IN CENTS PER $100 OF DEPOSITORS' AVERAGE NET ASSETS
(for periods ended December 31)



CDP Financial

CDP Financial is a wholly owned subsidiary of La Caisse. Its transactions are designed to optimize the cost of financing the operations of La Caisse and its subsidiaries, diversify their sources of financing and match financed assets in terms of currencies and interest rates. To achieve its objectives, it has two financing programs on the local and international institutional markets: short-term borrowing and term borrowing.

SHORT-TERM BORROWING

As at December 31, 2013, short-term financing totalled $1.5 billion, with $1 billion on the Canadian market and US$500 million on the U.S. market. The average maturity of the borrowings on the Canadian market was 81 days, and transactions totalled $5 billion during the year, while the average maturity of the borrowings on the U.S. market was 118 days, and transactions totalled US$500 million in 2013.

TERM BORROWING

As at December 31, 2013, the fair value of CDP Financial's outstanding term notes totalled $9 billion, versus $8.9 billion at the end of 2012 (see Figure 55). The change from 2012 is due to interest rate fluctuations and the effect of depreciation of the Canadian dollar. Because there was no specific need for additional term financing, no new notes were issued in 2013.

CREDIT RATING AGENCIES AFFIRM LA CAISSE'S FINANCIAL STRENGTH

Dominion Bond Rating Services (DBRS), Moody's Investors Service (Moody's) and Standard & Poor's (S&P) affirmed their investment-grade credit ratings with a stable outlook (see Table 56). In addition, the agencies issued the highest rating to the new U.S. short-term financing program. Updates confirming CDP Financial's and La Caisse's credit ratings were published on November 15, 2013.

FIGURE 55

BREAKDOWN OF LIABILITIES – CDP FINANCIAL
(fair market value as at December 31 – in billions of dollars)

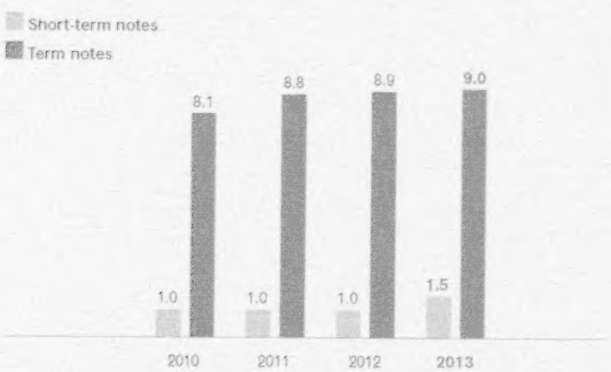


TABLE 56

CREDIT RATINGS

	Short-term	Long-term
DBRS	R-1 high	AAA
Moody's	Prime-1 (Aaa)	Aaa
S&P	A-1 + A-1 HIGH	AAA

Significant Accounting Policies

The financial statements of La Caisse de dépôt et placement du Québec are combined: they comprise the accounts of its subsidiaries, the General Fund, the individual funds and the specialized portfolios. Depositors' holdings presented in the Combined statement of net assets include the net account value of each Caisse depositor. Note 2 to the audited combined financial statements as at December 31, 2013 describes the significant accounting policies used by La Caisse.

EXTERNAL AUDIT

La Caisse's financial statements are prepared in accordance with the prevailing accounting standards, namely Canadian generally accepted accounting principles (GAAP), as stipulated in the Act respecting the Caisse de dépôt et placement du Québec.

In accordance with the Act, the co-auditors audited all of La Caisse's accounting records and issued an unqualified auditors' report for each of the 59 financial statements.

CHANGEOVER TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In October 2012, the IASB published *Investment Entities*, applicable to a company such as La Caisse. In December 2012, Part I of the CPA Canada Handbook was updated to reflect the recent amendments, whose effective date and transition date are January 1, 2014, and January 1, 2013, respectively. Accordingly, the date for La Caisse's first combined financial statements prepared according to IFRS is December 31, 2014.

Implementation of IFRS

Once *Investment Entities* was published, La Caisse initiated its IFRS conversion program. In accordance with its timetable, in fiscal 2013 the institution completed several key steps of its detailed plan, including changes to accounting and business processes, operating systems and internal controls. La Caisse also validated its accounting positions completed to date with the co-auditors, prepared an opening balance sheet and preliminary comparative figures and started to prepare draft annual IFRS financial statements.

Main IFRS accounting standards applicable to La Caisse's financial statements

Adoption of IFRS will result in changes affecting reporting, valuation, presentation and disclosure in financial statements. The preliminary analyses conducted to date could vary as a result of new facts likely to arise before the first annual IFRS financial statements are published, given that the new standards will evolve. The main standards that have an impact on La Caisse are discussed below.

Investment entities

Under Canadian GAAP, La Caisse consolidates its subsidiaries whereas, according to IFRS, these subsidiaries must be presented and measured at fair value as investments. The fair value of the assets and liabilities of subsidiaries that are consolidated according to Canadian GAAP could differ significantly from the measurement of an investment based on an enterprise value method according to IFRS. When the first annual combined financial statements according to IFRS are prepared, the adjustment of $702 million from the early adoption of IFRS by the Real Estate portfolio will be recorded in depositors' combined net holdings as at January 1, 2014. In addition to this adjustment, La Caisse is analyzing the other impacts that application of this standard will have, including a decrease in its total assets and liabilities.

Fair value measurement

IFRS 13 *Fair Value Measurement* provides a single source of guidelines for all fair value measurements. Fair value is the price that is received on the sale of an asset or is paid to transfer a liability in an orderly transaction between market participants at the measurement date. According to analyses completed to date, adoption of IFRS 13 should not have a significant impact at the IFRS transition date.

Reporting and disclosure

Given that information is reported in accordance with several IFRS standards, additional information will have to be included in the notes to the financial statements.

During fiscal 2014, La Caisse will finalize its analysis of the accounting and information requirements for the first IFRS-compliant annual financial statements and will finish upgrading the systems, processes and controls required for such disclosure.

Fair Value Measurement

Investment valuation is a process whereby a fair value is assigned to each of La Caisse's investments with a view to preparation of its financial statements. Measurement of investments at fair value is performed periodically according to policies and procedures specific to each type of investment. These procedures comply with the standards and practices of Canadian and international organizations and involve the use of stock market prices as well as reports of independent valuators, appraisers and experts. The co-auditors have access to all major valuation files in performing their audit of the year-end financial statements.

CONCEPTUAL FRAMEWORK

According to the provisions of CPA Canada Handbook Accounting Guideline AcG-18, La Caisse must measure its investments at fair value. Fair value is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value must be established on the assumption that the investments are available for sale on the preparation date of the financial statements. The purpose of the accounting standards is to define a conceptual framework for all situations that require fair value measurement.

IMPACT ON LA CAISSE'S INVESTMENTS

La Caisse believes that these fair value standards provide a coherent framework. However, these highly restrictive standards ignore the fact that, given the very long investment horizon of its main depositors, La Caisse has the resources and the intention to hold certain investments until their optimal value is reached.

As a result, the fair value determined as at December 31, 2013, for less liquid investments, such as real estate, private equity, infrastructure, commercial debt and commercial mortgages, reflects the overall volatility of the financial markets and therefore may differ from the economic value of such investments over the long term.

ESTABLISHING FAIR VALUE AT LA CAISSE

The fair value of investments is established first as a function of real transactions involving identical or comparable assets in active markets. However, if there are no observable data or the markets are inactive, that is, no purchases or sales are taking place, La Caisse must establish fair value using valuation methods. The main valuation methods currently used are discounting of cash flows and the earnings multiples of comparable companies. The main variables used by these methods are cash flows, discount rates, financing and illiquidity premiums, EBITDA multiples and price-earnings multiples. These methods require the use of estimates and assumptions. They are carried out with all the rigour required in such a process.

Liquid investments

The fair value of liquid investments is established from prices quoted on major stock exchanges and prices or data provided by securities dealers or other recognized specialized organizations, and from valuation methods used on capital markets, such as discounting of cash flows, which is based on directly or indirectly observable data. Twice a year, the fair value of all portfolios of unlisted liquid products is reviewed by independent external firms. Valuation of these products, which include bonds and over-the-counter derivative financial instruments, is based on valuation models and input data.

Less liquid investments

Private equity and infrastructure

The fair value of private equity and infrastructure investments is determined semi-annually, at June 30 and December 31, unless significant circumstances require a change in the value of an investment at another time during the year.

Fair value is established by an internal valuation team, independent of the investment units. Investments whose fair value exceeds a predetermined materiality threshold must be submitted to an independent valuation committee or an external valuator. The committee, which reports to La Caisse's Audit Committee, is composed of independent valuation professionals. The co-auditors attend the committee's meetings as observers. The process is complemented internally by regular and one-time valuations, as events occur.

Fair Value Measurement

Real estate investments

The fair value of real estate investments is determined semi-annually, at June 30 and December 31, unless significant known circumstances require a one-time investment valuation adjustment. External chartered appraisers certify the fair value of the real estate assets. In addition, the real estate subsidiaries' external auditors audit fair values during preparation of the audited financial statements.

Furthermore, IFRS were early adopted in 2012 for the Real Estate portfolio. According to IFRS, this portfolio is considered an investment entity and the new accounting standard requires that the subsidiary Ivanhoé Cambridge be valued and presented as an investment that reflects the fair value of the business. This value was determined by independent external appraisers and reflects, among other things, the fair value of the real estate assets, the quality of the portfolio and the integrated management of the platform.

The fair value of mortgage loans and securities is established monthly from the discounted value of future contractual cash flows at the market interest rate. The rate is that which could be obtained for loans or securities with similar terms and maturities. In cases where the timing of cash flows cannot be estimated with reasonable reliability, fair value is either the fair value of any asset given as collateral, net of expected costs of realization and any amount legally owed to borrowers, or the mortgages' observable market price. The fair value of these investments is reviewed semi-annually by independent external firms.

ABTNs

Asset-backed term notes (ABTNs) are financial instruments with an average maturity of three years. To provide an economic hedge so as to reduce the risk of loss inherent in changes in the ABTNs' fair value and of possible collateral calls, La Caisse uses derivative financial instruments, such as credit default swaps and interest rate swaps.

The Master Asset Vehicle 1 (MAV1) ABTNs and some ABTNs excluded from the restructuring agreement are essentially composed of credit default swaps and pledged assets. The fair value of the credit default swaps is established with valuation techniques that are based as much as possible on observable market data, such as credit spreads, correlation factors and an illiquidity premium, which is calculated from the spread between the bid and ask prices of similar financial instruments traded on the market. For the other ABTNs, La Caisse established fair values using a valuation technique based on a financial model whose assumptions use observable market data, such as interest rates and credit quality, as much as possible.

All the data and methodologies used to establish the fair value of the ABTNs as at December 31, 2013 were reviewed by an independent external firm.